CA FOUNDATION

CRACK D
TEST SERIES

ACCOUNTING THEORY

MOST iMP THEORY QUESTIONS
FROM MTPs , RTPs & PAST PAPERS OF THE ICAI

दक्षिणामूर्ति प्रकाशन

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THEORY QUESTIONS FROM MTPS, RTPS & PAST PAPERS

I] Short notes :-

1] Meaning of Accounting:- (RTP May)

Accounting is the art of recording, classifying, summarizing, analyzing, interpreting and communicating the financial information of an entity.

Recording—It is concerned with the recording of measured financial transactions in an orderly manner in the proper books of accounts.

Classifying—It is concerned with the classification of the recorded transactions so as to group the transactions of similar type at one place.

Summarising—It is concerned with the summarization of the classified transactions in a manner useful to the users. This function involves the preparation of financial statements such as Income Statement, Balance Sheet.

Analysing—It is concerned with the establishment of relationship between the various items or group of items taken from Income statement of Balance Sheet or both.

Interpreting—It is concerned with explaining the meaning and significance of the relationship so established by the analysis.

Communicating — It is concerned with the transmission of summarised, analysed and interpreted information to the users to enable them to make reasoned decisions.

2] Objectives of Accounting :- (RTP May)

The objectives of Accounting are -
1. Systematic record all business transactions.
2. Know the result of business operations.
3. Know the financial position.
4. Provide information to Users for decision making.

3] Functions of Accounting: (RTP Dec)

1. **Measurement:**Accounting measures past performance of the business entity and depicts its current financial position.
2. **Forecasting:**Accounting helps in forecasting future performance and financial position of the enterprise using past data.
3. **Decision-making:**Accounting provides relevant information to the Users of accounts to aid rational decision-making.
4. **Comparison & Evaluation:**Accounting assesses performance achieved in relation to targets and discloses information regarding accounting policies and Contingent Liabilities, which play an important role in predicting, comparing and evaluating the financial results.
5. **Control:**Accounting identifies weaknesses in the operational system and provides feedback regarding effectiveness of measures to rectify such weaknesses.
6. **Government Regulation:** Accounting provides necessary information to the Government, to exercise control on the entity as well as in collection of direct and indirect tax revenues.

4] Limitations of Accounting:

1. **Assumptions &conventions:-**Accounting involves different assumptions and conventions on which it is based. These assumptions, by themselves, become a limitation for accounting.

2. **Static :-**Balance Sheet is a static document and not a dynamic one, i.e. it shows the position of the business on the day of its preparation and not for the future.

3. **Inflation:-**Inflation effectis not considered in the general purpose Financial Statements.

4. **Non- monetary transactions:-**Accounting ignores the real assets which cannot be measured in terms of money, i.e. Employees. There is no generally accepted formula for the valuation of Human Resources in terms of money.

5. Different Accounting Policies:-There are different accounting policies for the treatment of the same item, e.g. Depreciation, Valuation of Stocks, etc. This may not ensure comparability among Financial Statements of various Firms.

6. **Accounting estimates:-**Certain accounting estimates are based on the personal judgement of the Accountant, e.g. provision for doubtful debts, capital vs revenue expenditure, writing off intangible assets, etc. This may lead to the possibility of manipulations.

5] Sub fields of Accounting:- (Exam Dec 23)

The various sub-fields of accounting are:
(**i) Financial Accounting** – It covers the preparation and interpretation of financial statements and communication to the users of accounts. It is historical in nature as it records transactions which had already been occurred. The final step of financial accounting is the preparation of Profit and Loss Account and the Balance Sheet. It primarily helps in determination of the net result for an accounting period and the financial position as on the given date.
(ii) Management Accounting – It is concerned with internal reporting to the managers of a business unit. To discharge the functions of stewardship, planning, control, and decision- making,

the management needs variety of information. The different ways of grouping information and preparing reports as desired by managers for discharging their functions are referred to as management accounting. A very important
component of the management accounting is cost accounting which deals with cost ascertainment and cost control.
(iii) Cost Accounting – The process of accounting for cost which begins with the recording of expenditure or the bases on which they are calculated and ends with the preparation of periodical statements and reports for ascertaining and controlling costs.
(iv) Social Responsibility Accounting – The demand for social responsibility accounting stems from increasing social awareness about the undesirable by - products of economic activities., Social responsibility accounting is concerned with accounting for social costs incurred by the enterprise and social benefits created.
(v) Human Resource Accounting – Human resource accounting is an attempt to identify, quantify and report investments made in human resources of an organisation that are not presently accounted for under conventional accounting practice.

6] Users of accounting information (RTP May)

Users	Purpose
Management	For day-to-day decision-making and performance evaluation.
Proprietor / Shareholders	To analyse performance, profitability and financial position. Note: Prospective investors are interested in the track record of the Company.
Lenders - Banks & Fin. Institutions	To determine the financial position and strength of the Company, Debt Service Coverage, etc.
Suppliers	To determine the credit worthiness of the Company.
Customers	To know the general business viability before entering into long-term contracts and arrangements.
Employees	To know the stability, continuity and growth of the enterprise, and its ability to pay remuneration, retirement & other benefits.
Government	# To ensure prompt collection of Direct and Indirect Tax revenues, # To evaluate performance and contribution to social objectives.
Research Scholars	For study, research and analysis purposes.
Public at Large	To see whether the enterprise is making a reasonable / substantial contribution to the local economy, e.g. employment opportunities, patronage of local suppliers.

7] Accounting conventions/ Concepts / Principles (RTP Sept 24)

Accounting conventions emerge out of accounting practices, commonly known as accounting principles, adopted by various organizations over a period of time. These conventions are derived by usage and practice. The accountancy bodies of the world may change any of the convention to improve the quality of accounting information. Accounting conventions need not have universal application.

Concepts	• "Concept" means any idea or notion, **which has a universal application**, (b) Accounting Concepts are the basic assumptions and conditions, which lay down the foundation on the basis of which the accounting principles are formulated.
Principles	• "Principles" refer to the set of doctrines associated with the theory procedures of accounting, serving as an explanation of current practices and as a guide for selection of conventions or procedures where alternatives exist.
Conventions	• Accounting Conventions are the general procedures emerging out of usage practice of accounting principles. It may not have universal application.

8] Capital redemption Reserve:-

A Capital Redemption Reserve (CRR) is a mandatory reserve that companies create to maintain their capital base when they buy back or redeem their own shares. The CRR is created by allocating a portion of a company's distributable profits to a separate reserve. This helps to ensure that the company doesn't dip into its core capital, which helps to maintain financial stability.

The reason of creation of capital redemption reserve account is due to following reasons:-

- To protect the **interest of creditors.**
- To maintain **working capital.**

Redemption of preference shares involves repayment of capital before paying creditors of the company. It may affect the interest of creditors. In addition to that the working capital of the company will be depleted as a result of outflow of cash due to redemption. The amount is capitalized by creating the capital redemption reserve account. As a result, this amount will not be available for distribution of dividend. It helps to protect the interest of creditors and on the other hand it does not disturb the working capital.

9] Fundamental Accounting Assumptions:- (RTP MAY 2018, RTP JAN 25)

Fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed. The Institute of Chartered Accountants of India issued Accounting Standard (AS) 1 on 'Disclosure of Accounting Policies' according to which the following have been generally accepted as fundamental accounting assumptions:

1. Going concern (Exam paper May 2019): The enterprise is normally viewed as a going concern, i.e. as continuing operations for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

2. Consistency: It is assumed that accounting policies are consistent from one period to another.

3. Accrual: Guidance Note on 'Terms used in Financial Statements' defines accrual basis of accounting as "the method of recording transactions by which revenue, costs, assets and liabilities are reflected in the accounts in the period in which they accrue."

10] Accounting Policies (RTP Jan 25)

Accounting policies refer to the specific **accounting principles and methods of applying those principles** adopted by the enterprise in the **preparation and presentation of financial statements.** There is no single list of accounting policies which are applicable to all enterprises in all circumstances. The management of each enterprise has to select appropriate accounting policies having regard to the nature and circumstances of the enterprise.

Following are the examples of some of the areas in which different accounting policies may be adopted by different enterprises:
(i) Methods of depreciation, depletion and amortisations;
(ii) Treatment of expenditure during construction;
(iii) Conversion or translation of foreign currency items;
(iv) Valuation of inventories;
(v) Treatment of goodwill;
(vi) Valuation of investments;
(vii) Treatment of retirement benefits;
(viii) Recognition of profit on long-term contracts;
(ix) Valuation of fixed assets;
(x) Treatment of contingent liabilities.

11] Measurement.(RTP May 2020)

Measurement is vital aspect of accounting. Primarily transactions and events are measured in terms of money. Any measurement discipline deals with three basic elements of measurement viz., identification of objects and events to be measured, selection of standard or scale to be used, and evaluation of dimension of measurement standards or scale.

Kohler defined measurement as the assignment of a system of ordinal or cardinal numbers to the results of a scheme of inquiry or apparatus of observations in accordance with logical or mathematical rules.

Three important elements of measurement are:
(1) Identification of objects and events to be measured;
(2) Selection of standard or scale to be used;
(3) Evaluation of dimension of measurement standard or scale.

12] Valuation Principles or Measurement Basis used in Accounting (RTP May 2020)

There are four generally accepted valuation principles or measurement bases.

#Historical Cost Base

As per Historical Cost base — (a) the assets are recorded at the amount of cash or cash equivalent paid or incurred or fair value of the asset at the time of acquisition. (b) Liabilities are recorded at the amount of proceeds received in exchange for the obligation.

Current Cost Base

As per Current Cost base — (a) the assets are recorded at the amount of cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently. (b) Liabilities are recorded at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

#Realizable Value Base

As per realizable value base — (a) The assets are recorded at the amount of cash or cash equivalent that could currently be obtained by selling the assets in an orderly disposal. (b) Liabilities are recorded at the undiscounted amount of cash or cash equivalents expressed to be paid to satisfy the liabilities in the normal course of business.

Present Value Base

As per Present Value Base— (a) An asset is recorded at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. (b) Liabilities are recorded at the present discounted value of future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

13] Meaning & Objectives of Accounting Standards. (RTP Jan 25 / May 22)

Meaning:- Accounting standards are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, treatment, measurement, presentation and disclosure of accounting transactions and events in the financial statements.

Objectives: - Accounting Standards are selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. The main objective of Accounting Standards is to establish standards which have to be complied with, to ensure that financial statements are prepared in accordance with generally accepted accounting principles. Accounting Standards seek to suggest rules and criteria of accounting measurements. These standards harmonize the diverse accounting policies and practices at present in use in India.

14] Cash and mercantile system: (RTP Sept 24) (MTP I SEPT 2024)

Cash system of accounting is a system by which a transaction is recognized only if cash is received or paid. In cash system of accounting, entries are made only when cash is received or paid, no entry being made when a payment or receipt is merely due. Cash system is normally followed by professionals, educational institutions or non-profit making organizations.

On the other hand, mercantile system of accounting is a system of classifying and summarizing transactions into assets, liabilities, equity (owner's fund), costs, revenues and recording thereof. A transaction is recognized when either a liability is created/ impaired and an asset is created /impaired. A record is made on the basis of amounts having become due for payment or receipt irrespective of the fact whether payment is made or received actually. Mercantile system of accounting is generally accepted accounting system by business entities.

15] Double entry syatem:- (MTP June 23)

Double entry system may be defined as that system which recognizes and records both the aspects of a transaction. Every transaction has two aspects and according to this system, both the aspects are recorded. This system was developed in the 15th century in Italy by Luca Pacioli. It has proved to be systematic and has been found of great use for recording the financial affairs for all institutions requiring use of money. This system offers the under mentioned advantages:

(a) By the use of this system, the accuracy of the accounting work can be established through the device of trial balance.
(b) The profit earned or loss suffered during a period can be ascertained together with details.
(c) The financial position of the firm or the institution concerned, can be ascertained at the end of each period, through preparation of the balance sheet.
(d) The system permits accounts to be kept in as much detail as necessary and therefore, affords significant information for the purpose of control etc.
(e) Result of one year may be compared with those of previous years and reasons for the change may be ascertained. It is because of these advantages that the double entry system has been used extensively in all countries.

16] Meaning & importance of Journal:- (Exam June 22)

Meaning :- Transactions are first entered in a book called 'Journal' to show which account should be debited and which should be credited. Journal creates preliminary records and, is also called subsidiary book. All transactions are first recorded in the journal as and when they occur, the record is chronological, otherwise it would be difficult to maintain the records in an ordinary manner. Journal gives details regarding any transaction. Thus journal tells the amounts to be debited and credited and also the accounts involved.

Importance of Journal:-

1. **Chronological Order:** As transactions are recorded on chronological order, one can get complete information about the business transactions on time basis.
2. **Narration:** Entries recorded in the journal are supported by a note termed as narration, which is a precise explanation of the transaction for the proper understanding of the entry. One can know the correctness of the entry through these narrations.
3. **Basis of Posting:** Journal forms the basis for posting the entries in the ledger. This eases the accountant in their work and reduces the chances of error.

17] Posting of journal entries into the Leger. (RTP Sept 24)

Rules regarding posting of entries in the ledger:
1. Separate account is opened in ledger book for each account and entries from journal are posted to respective ledger account accordingly.
2. It is a practice to use words 'To' and 'By' while posting transactions in the ledger. The word 'To' is used in the particular column with the accounts written on the debit side while 'By' is used with

the accounts written in the particular column of the credit side. These 'To' and 'By' do not have any meanings but are used to the account debited and credited.
3. The concerned account debited in the journal should also be debited in the ledger but reference should be of the respective credit account.

18] Which subsidiary books are normally used in a business? (MTP I SEPT 2024, Dec 2022)

Normally, the following subsidiary books are used in a business:
(i) Cash book to record receipts and payments of cash, including receipts into and payments out of the bank.
(ii) Purchases book to record credit purchases of goods dealt in or of the materials and stores required in the factory.
(iii) Purchase Returns Books to record the returns of goods and materials previously purchased.
(iv) Sales Book to record the sales of the goods dealt in by the firm.
(v) Sale Returns Book to record the returns made by the customers.
(vi) Bills receivable books to record the receipts of promissory notes or hundies from various parties.
(vii) Bills Payable Book to record the issue of the promissory notes or hundies to other parties.
(viii) Journal (proper) to record the transactions which cannot be recorded in any of the seven books mentioned above.

19] Advantages of Subsidiary Books ((Exam paper 2024)) (Exam June 2021)

The use of subsidiary books affords the undermentioned advantages:
(i) **Division of work:** Since in the place of one journal there will be so many subsidiary books, the accounting work may be divided amongst a number of clerks.
(ii) **Specialization and efficiency:** When the same work is allotted to a particular person over a period of time, he acquires full knowledge of it and becomes efficient in handling it. Thus, the accounting work will be done efficiently.
(iii) **Saving of the time:** Various accounting processes can be undertaken simultaneously because of the use of a number of books. This will lead to the work being completed quickly.
(iv) **Availability of information:** Since a separate register or book is kept for each class of transactions, the information relating to each class of transaction be available at one place.
(v) **Facility in checking:** When the trial balance does not agree, the location of the error or errors is facilitated by the existence of separate books. Even the commission of errors and frauds will be checked by the use of various subsidiary books.

20] Importance of bank reconciliation to an industrial unit. (RTP Jan 25) (MTP June 23)

Banks are essential to modern society, but for an industrial unit, it serves as a necessary instrument in the commercial world. Most of the transactions of the business are done through bank whether it is a receipt or payment. Rather, it is legally necessary to operate the transactions through bank after a certain limit. All the transactions, which have been operated through bank, if not verified properly, the industrial unit may not be sure about its liquidity position in the bank on a particular date.

There may be some cheques which have been issued, but not presented for payment, as well as there may be some deposits which has been deposited in the bank, but not collected or credited so far. Some expenses might have been debited or bills might have been dishonoured. It is not known to the industrial unit in time, it may lead to wrong conclusions. The errors committed by bank may not be known without preparing bank reconciliation statement.

Preparation of bank reconciliation statement prevents the chances of embezzlement. Hence, bank reconciliation statement is very important and is a necessity of an industrial unit as it plays a key role in the liquidity control of the industry.

21] Causes of difference between the balance shown by the pass book and the cash book.
(MTP I SEPTEMBER 2024)

The difference between the balance shown by the passbook and the cashbook may arise on account of the following:
(i) Cheques issued but not yet presented for payment.
(ii) Cheques deposited into the bank but not yet cleared.
(iii) Interest allowed by the bank.
(iv) Interest and expenses charged by the bank.
(v) Interest and dividends collected by the bank.
(vi) Direct payments by the bank.
(vii) Direct deposits into the bank by a customer.
(viii) Dishonour of a bill discounted with the bank.
(ix) Bills collected by the bank on behalf of the customer.
(x) An error committed by the bank etc.

22] Objectives of preparing Trial Balance. ((RTP Sept 24) (RTP JUNE 2024)

Objectives of preparing trial balance The preparation of trial balance has the following objectives:

1) Checking of the arithmetical accuracy of the accounting entries: Trial Balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trial balance helps to establish the arithmetical accuracy of the books.

2) Basis for preparation of financial statements: Trial Balance forms the basis for preparing financial statements such as the Income Statement and the Balance Sheet. The Trial Balance represents all transactions relating to different accounts in a summarized form for a particular period. In case, the Trial Balance is not prepared, it will be almost impossible to prepare the financial statements to know the profit or loss made by the business during a particular period or its financial position on a particular date.

3) Summarized ledger: Trial Balance contains the ledger balances on a particular date. Thus, the entire ledger is summarized in the form of a Trial Balance. The position of a particular account can be judged simply by looking at the Trial Balance. The ledger may be seen only when details regarding the accounts are required.

23] Machine Hour Rate method of calculating depreciation. (RTP Sept 24)

Where it is practicable to keep a record of the actual running hours of each machine, depreciation may be calculated on the basis of hours that the concerned machinery worked. Under machine hour rate method of calculating depreciation, the life of a machine is not estimated in years but in hours.

Thus depreciation is calculated after estimating the total number of hours that machine would work during its whole life; however, it may have to be varied from time to time, on a consideration of the changes in the economic and technological conditions which might take place, to ensure that the amount provided for depreciation corresponds to that considered appropriate in the changed circumstances.

Proper records are maintained for running hours of the machine and depreciation is computed accordingly. For example, the cost of a machine is `10,00,000 and life of the machine is estimated at 50,000 hours. The hourly depreciation will be calculated as follows:

$$\text{Hourly Depreciation} = \frac{\text{Total cost of Machine}}{\text{Estimated life of Machine}}$$

$$= \frac{₹10,00,000}{50,000\text{ hours}}$$

$$= ₹\ 20 \text{ per hour}$$

If the machine runs for say, 2,000 hours in a particular period, depreciation for the period will be 2,000 hours × ₹ 20 = 40,000.

24] Contingent Asset and Contingent Liability (RTP Sept 24) (Exam Dec 2021)

Contingent Asset An asset the existence, ownership or value of which may be known or determined only on the occurrence or non-occurrence of one or more uncertain future events.

Contingent Liability An obligation relating to an existing condition or situation which may arise in future depending on the occurrence or non-occurrence of one or more uncertain future events.

25] Liability of LLP and its Partners. (RTP JUNE 2024)

Extent of Liability of LLP and its partners Every partner of an LLP for the purpose of its business is an agent
of the LLP but is not an agent of other partners. Obligations of LLP are solely its obligations and liabilities of LLP are to be met out of properties of LLP. The partners of an LLP in the normal course of business are not liable for the debts of the LLP.

The LLP is liable if a partner of LLP is liable to any person as a result of wrongful or omission on his part in the course of business of the LLP or with his authority. However, a partner will be liable for his own wrongful acts or commissions, but will not be liable for the wrongful acts or commissions of other partners of the LLP. Thus a partner may be called to pay the liability of an LLP under exceptional circumstances.

If an LLP or any of its partners act with the intent to defraud creditors of the LLP or any other person or for any fraudulent purpose, then the liability of the LLP and the concerned partners is unlimited. However, where the fraudulent act is carried out by a partner, the LLP is not liable if it is established by the LLP that the act was without the knowledge or authority of the LLP. Where the business is carried out with fraudulent intent or for fraudulent purpose, every person who was knowingly a party is punishable with imprisonment and fine.

26] Requirement to create Debenture Redemption Reserve. (RTP JUNE 2024)

Section 71 of the Companies Act 2013 covers the requirement of creating a debenture redemption reserve
account. Section 71 states as follows:
(1) Where a company issues debenture under this section, it should create a debenture redemption reserve account out of its profits which are available for distribution of dividend every year until such debentures are redeemed.
(2) The amounts credited to the debenture redemption reserve should not be utilised by the company for any purpose except for the purpose aforesaid.
(3) The company should pay interest and redeem the debentures in accordance with the terms and conditions of their issue.
(4) Where a company fails to redeem the debentures on the date of maturity or fails to pay the interest on debentures when they fall due, the Tribunal may, on the application of any or all the holders of debentures or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith by the payment of principal and interest due thereon.

27] Adjusted Selling Price method of determining cost of stock. (MTP I SEPT 2024)

Adjusted selling method is also called retail inventory method. It is used widely in retail business or in business where the inventory comprises of items, the individual costs of which are not readily ascertainable. The historical cost of inventory is estimated by calculating it in the first instance at selling price and then deducting an amount equal to the estimated gross margin of profit on such stocks.

28] Principal methods of ascertainment of cost of inventory. (MTP I SEPT 2024)

The specific identification method, First-In–First-Out (FIFO) and weighted average cost formulae are the principal methods of ascertaining the cost of inventory. The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs under the specific identification method.

29] Bill of exchange and the various parties to it. [MTP JUNE II 2024)

A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money to or to the order of certain person or to the bearer of the instrument. When such an order is accepted by the drawee on the face of the order itself, it becomes a valid bill of exchange. There are three parties to a bill of exchange:

- The drawer, who draws the bill, that is, the creditor to whom the money is owing;
- The drawee, the person to whom the bill is addressed or on whom it is drawn and who accepts the bill that is, the debtor; and

- The payee, the person who is to receive the payment. The drawer in many cases is also the payee.

30] Retirement of bills of exchange. (RTP Jan 25) (MTP II JUNE 2024) (RTP MAY 22)

Sometimes, the acceptor of a bill of exchange has spare funds much before the maturity date of the bill of exchange accepted by him. He may, therefore, desire to pay the bill before the due date. In such a circumstance, the acceptor shall ask the payee or the holder of the bill to accept cash before the maturity date. If the payee agrees, the acceptor may be allowed a rebate or discount on such early payment. This rebate is generally the interest at an agreed rate for the period between the date of payment and date of maturity. The interest/rebate/ discount becomes the income of the acceptor and expense of the payee. It is a consideration for premature payment. When a bill is paid before due date, it is said to be retired under rebate.

31] Write short notes on Accommodation bill and Renewal of bill.(RTP MAY 20) (MTP June 2024)

Bills of Exchange are usually drawn to facilitate trade transmission, that is, bills are meant to finance actual purchase and sale of goods. But the mechanism of bill can be utilised to raise finance also. When bills are used for such a purpose, they are known as accommodation bills. When the acceptor of a bill finds himself in financial straits to honour the bill on the due date, then he may request the drawer to cancel the original bill and draw on him a fresh bill for another period. And if the drawer agrees, a new bill in place of the original bill may be accepted by the drawee for another period. This is called the renewal of bill.

32] Noting Charges: (RTP MAY 22)

It is necessary that the fact of dishonour and the causes of dishonour should be established. If there is a fear of dishonour, the bill will be given to the public official known as "Notary Public". These officials present the bill for payment and if the money is received, they will hand over the money to the original party. But, if the bill is dishonoured they will note the fact of dishonour, and the
reasons given and give the bill back to their client. For this service, they charge a small fee. This fee is known as noting charges. The amount of noting charges is recoverable from the party who is responsible for dishonour.

33] Services provided by Chartered Accountant to the society (RTP JUNE 2024) (Exam Dec 2020)

The practice of accountancy has crossed its usual domain of preparation of financial statements, interpretation of such statements and audit thereof. Chartered Accountants are presently taking active role in company laws and other corporate legislation matters, in taxation laws matters (both direct and indirect) and in general management problems. Some of the services rendered by chartered accountants to the society are briefly mentioned hereunder:
(i) Maintenance of books of accounts;
(ii) Statutory audit;
(iii) Internal Audit;
(iv) Taxation;
(v) Management accounting and consultancy services;
(vi) Financial advice and financial investigations etc.
(vii) Other services like secretarial work, share registration work, company formation receiverships, arbitrations etc.

34] Petty Cash book:- **(RTP & MTP)** **<u>Meaning of Petty Cash Book:-</u>**Petty Cash Book is one of the subsidiary books which is used for the purposes of recording the payment of petty cash expenses.

<u>Imprest vs. Non-Imprest System of Petty Cash Book</u>

(a) **<u>Meaning of Imprest or Float:-</u>**'Imprest' or 'Float' is the amount which the main cashier hands over to the petty cashier in order to meet the petty cash expenses of a given period.

(b) Petty Cash book may be maintained on imprest system on non-imprest system.

(i) **<u>Imprest System of Petty Cash</u>:-** Under imprest system. The Chief Cashier makes the reimbursement of the amount spent by the Petty Cashier and the Petty Cashier again has the same amount of petty cash at the end as in the beginning.

(ii) **<u>Non-imprest System of Petty Cash</u>:-** Under non-imprest system, the Chief Cashier may hand over the cash to the Petty Cashier equal to/more than less than the amount spent by the petty cashier. The Petty cashier may or may not have the same closing balance of petty cash as opening balance.

(c) Advantages of Imprest System Petty Cash The Advantages of imprest system of petty cash are as follows:

1. **<u>Control over Mistakes:-</u>**

2. **<u>Control over Petty Expenses</u>**:-

3. **<u>Control over Fraud</u>**:-

35] Journal Proper:- (RTP) Journal Proper is a residuary book in which those transactions are recorded which cannot be recorded in any other subsidiary book such as (a) Cash Book, (b) Purchases Book, (c) Sales Book, (d) Purchases Returns Book, (e) Sales Returns Book, (f) Bills Receivable Book, and (g) Bills Payable Book.

36] Reserve Capital:- (RTP & MTP)

Reserve Share Capital : As per Section 65 of the Companies Act, 2013, a Company may decide by passing a resolution that a certain portion of its subscribed uncalled capital shall not be called up except in the event of winding up of the company.

Portion of the uncalled capital which a company has decided to call only in case of liquidation of the company is called Reserve Capital.

Reserve Capital is different from Capital reserve, Capital reserves are part of 'Reserves and Surplus' and refer to those reserves which are not available for declaration of dividend. Whereas, reserve capital which is portion of the uncalled capital to be called up in the event of winding up of the company is entirely different in nature from capital reserve which is created out of capital profits only.

37] CALLS-IN-ARREARS:-

Sometimes shareholders **fail to pay the amount due on allotment or calls.** The **total unpaid** amount on one or more instalments is known as **Calls-in-Arrears or Unpaid Calls.** Such amount represents the uncollected amount of capital from the shareholders; hence, it is shown by way of deduction from 'called-up capital' to arrive at paid-up value of the share capital.

The Articles of Association of a company usually empower the directors to charge interest at a stipulated rate on calls-in-arrears. According to **Table F** interest at the **rate of 10%**per annum is to be charged on unpaid calls for the period intervening between **the due date of the call and the**

time of actual payment. However, the directors have the authority **to waive** the application of this rule in individual cases at their discretion or **charge at a higher rate of interest.**

38] CALLS-IN-ADVANCE:-

Some shareholders may sometimes pay a part, or whole, of the amount not yet called up, such amount is known as Calls-in-advance. **According to Table F, interest at a rate not exceeding 12% p.a.** is to be paid on such **advance call money.** This amount is credited in Calls-in-Advance Account. **Calls received in advance are not entitled to any dividend.**

39] Revaluation reserve:-

1. Revaluation Reserve is a Reserve created on the revaluation of the Assets or Net Assets of an enterprise.
2. It represents the surplus of the estimated replacement cost or estimated market values over the Book Values of assets.
3. Revaluation Reserve represents unrealized Gain, and is hence not available for distribution as dividends.
4. As per the ICAI's Guidance Note, Revaluation Reserve should not be applied to declare dividends.
5. Revaluation Reserve cannot be applied in issuing Bonus Shares as per the Bonus Issue Guidelines, or in paying up Debentures or Loan Stock or Calls on partly-paid Shares.

40] Debenture redemption Reserve:- (RTP JUNE 2024)

A company issuing debentures may be required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilised by the company for any other purpose except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they fall due for payment.

An appropriate amount is transferred from profits every year to Debenture Redemption Reserve and its investment is termed as Debenture Redemption Reserve Investment (or Debenture Redemption Fund). In the last year or at the time of redemption of debentures, Debenture Redemption Reserve Investments are encashed and the amount so obtained is used for the redemption of debentures.

II] Other Descriptive Questions:-

1] Change in accounting policy may have a material effect on the items of financial statements." Explain the statement with the help of an example. (MTP II JUNE 2024) (Exam paper 2024) (MTPs)

Ans.

Change in accounting policy may have a material effect on the items of financial statements. For example, cost formula used for inventory valuation is changed from weighted average to FIFO. Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts.

2] Classify the following expenditures as capital or revenue expenditure/receipt: (RTP Jan 25)

(i) An extension of railway tracks in the factory area.

Ans.

Expenses incurred for extension of railway tracks in the factory area should be treated as a Capital Expenditure because it will yield benefit for more than one accounting period.

(ii) Amount spent on painting the factory.

Ans.

Painting of the factory should be treated as a Revenue Expenditure because it has been incurred to maintain the factory building.

(iii) Payment of wages for building a new office extension

Ans.

Payment of wages for building a new office extension should be treated as a Capital Expenditure.

(iv) Premium received on issue of shares

Ans.

Premium received on issue of shares is an example of capital receipt.

(v) Rings and Pistons of an engine were changed to get full efficiency.

Ans.

Expenditure incurred for changing Rings and Pistons of an engine is a Revenue Expenditure because, the change of rings and piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.

(vi) Legal fees paid to acquire a property

Ans.

Legal fees paid to acquire a property is a part of the cost of that property. Hence, it is taken as capital expenditure.

3] Classify the following expenditures as capital or revenue expenditure: (MTP I SEPT 2024)

(i) Amount spent on making a few more exists in a Cinema Hall to comply with Government orders.
(ii) Travelling expenses of the directors for trips abroad for purchase of capital assets.
(iii) Amount spent to reduce working expenses.
(iv) Amount paid for removal of stock to a new site.
(v) Cost of repairs on second-hand car purchased to bring it into working condition.

Ans.

(i) Revenue Expenditure. (ii) Capital Expenditure. (iii) Capital Expenditure.
(iv) Revenue Expenditure. (v) Capital Expenditure.

4] Discuss the limitations which must be kept in mind while evaluating the Financial Statements. (MTP I SEPT 2024)

Ans.

Limitations which must be kept in mind while evaluating the Financial Statements are as follows:

• The factors which may be relevant in assessing the worth of the enterprise don't find place in the accounts as they cannot be measured in terms of money.
• Balance Sheet shows the position of the business on the day of its preparation and not on the future date while the users of the accounts are interested in knowing the position of the business in the near future and also in long run and not for the past date.
• Accounting ignores changes in some money factors like inflation etc.
• There are occasions when accounting principles conflict with each other.

5] Discuss the factors taken into consideration for calculation of depreciation. (MTP I SEPT 2024) (Exam Dec 2020)

Ans.

Following factors are taken into consideration for calculation of depreciation.

1) **Cost of asset** including expenses for installation, commissioning, trial run etc.- Cost of a depreciable asset represents its money outlay or its equivalent in connection with its acquisition, installation and commissioning as well as for additions to or improvement thereof for the purpose of increase in efficiency.

2) **Estimated useful life of the asset** - Useful Life' is either (i) the period over which a depreciable asset is expected to be used by the enterprise or (ii) the number of production or similar units expected to be obtained from the use of the asset by the enterprise. Determination of the useful life is a matter of estimation and is normally based on various factors including experience with similar type of assets. Several other factors like estimated working hours, production capacity, repairs and renewals, etc. are also taken into consideration on demanding situation.

3) **Estimated scrap value** (if any) is calculated at the end of useful life of the asset. If such value is considered as insignificant, it is normally regarded as nil. On the other hand, if the residual value is likely to be significant, it is estimated at the time of acquisition/installation, or at the time of subsequent revaluation of asset.

6] Explain, in brief, the basic considerations for distinguishing between capital and revenue expenditures? (July 2021)

Ans.

The basic considerations in distinction between capital and revenue expenditures are:
(i) Nature of business: For a trader dealing in furniture, purchase of furniture is revenue expenditure but for any other trade, the purchase of furniture should be treated as capital expenditure and shown in the balance sheet as asset.
(ii) Recurring nature of expenditure: If the frequency of an expense is quite often in an accounting year then it is said to be an expenditure of revenue nature while non-recurring expenditure is infrequent in nature and do not occur often in an accounting year.
(iii) Purpose of expenses: Expenses for repairs of machine may be incurred in course of normal maintenance of the asset. Such expenses are revenue in nature. On the other hand, expenditure incurred for major repair of the asset so as to increase its productive capacity is capital in nature.
(iv) Materiality of the amount involved: Relative proportion of the amount involved is another important consideration in distinction between revenue and capital.

7] Classify the following errors under the three categories – Errors of Omission, Errors of Commission and Errors of Principle.(RTP OCT 2021)

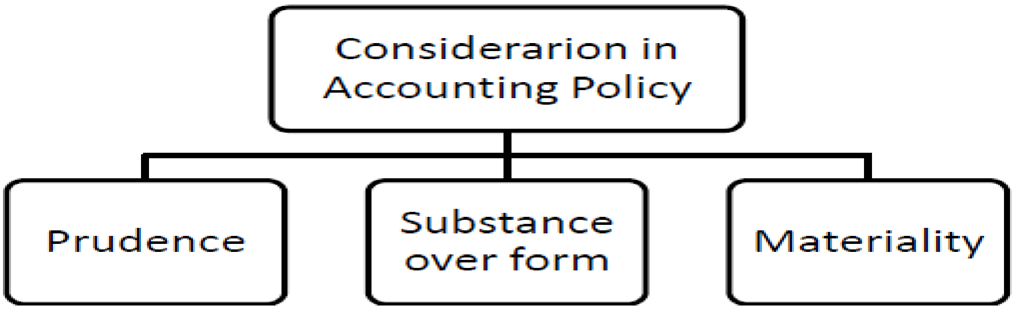
(i) Sale of furniture credited to Sales Account.
(ii) Purchase worth ₹ 500 from M not recorded in subsidiary books.
(iii) Credit sale wrongly passed through the Purchase Book.
(iv) Machinery sold on credit to Mohan recorded in Journal Proper but omitted to be posted.
(v) Goods worth ₹ 5000 purchased on credit from Ram recorded in the Purchase Book as ₹ 500.

(i) Error of Principle.	(ii) Error of Omission.	(iii) Error of Commission.
(iv) Error of Omission.	(v) Error of Commission	

8] Considerations in selecting Accounting Policy: (Exam paper June 2024)

Considerations in the Selection of Accounting Policies

The primary considerations in the selection of accounting policies should be to prepare and present financial statements in a way that they represent a true and fair view of the state of affairs of the enterprise as at the Balance Sheet date and of the Profit & Loss Account for the period ended on that date. The major considerations governing the selection and application of accounting policies are as under:



9] Discuss various Accounting Concepts:-

A) Business entity Concept :- Business Entity Concept means that the business enterprise is a separate identity and distinct from that of its Owners or Managers.

All transactions are classified into - (a) Business Transactions, and (b) Personal Transactions. **Business Transactions are recorded in the books of accounts of the business.** Owner's Personal transactions are recorded in his personal book of account.

The entity concept has the following impact for accounting -

(a) All transactions are recorded from the viewpoint of the entity itself and not from the viewpoint of other parties such as Owners, Managers or Customers.

(b) The enterprise is considered as liable to the Owner for the Capital invested by him, and he is considered as a Creditor / Lender to that extent.

B] Going Concern concept. (RTP Jan 25) (Exam May 2019)

Ans. The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

C] Dual Aspect concept

1. Meaning: The Dual Aspect Concept is the core of double entry book-keeping. As per this concept, every transaction or event has two aspects, which have to be recorded in the books. The combinations may be as under –

2. Significance: This concept gives rise to the accounting equation: "Capital + Liabilities = Assets".

D] Money Measurement Concept (Exam Dec 23/May 22)

Money Measurement concept: As per this concept, only those transactions, which can be measured in terms of money are recorded. Since money is the medium of exchange and the standard of economic value, this concept requires that those transactions alone that are capable of being measured in terms of money be only to be recorded in the books of accounts. Transactions and events that cannot be expressed in terms of money are not recorded in the business books.

E] Conservatism Concept:-

1. Conservatism or Prudence demands that unrealised profits and gains should not be recognised in the accounts. However, provision should be made for all actual and possible losses.

2. As per this concept, the Accountants should not anticipate income, but should provide all possible losses.

3. If there is a choice between two methods of valuing an asset, the Accountant should choose a method which leads **to the lesser value, e.g. Current Assets are valued at Cost or NRV, whichever is lower.**

4. Fixed Assets held for continuing use in the business are stated at their Net Book Value i.e. Historical Cost less Accumulated Depreciation.

F] Periodicity concept: (Exam may 22)

According to this concept, accounts should be prepared after every period not at the end of the life of the entity. This is also called the concept of definite accounting period. Usually, this period is one accounting year. We generally follow from 1st April of a year to 31st March of the immediately following year.

G] Matching Concept:- As per Matching Concept, Profit for any period — Periodic Revenue Less Matched Expenses.

Here, Expense of the period = Expense attributable to earning income during that period + Expense relatable to that period as such.

H] Consistency Concept:-

Consistency Concept recognises the fact that the accounting principles followed by the entity are consistent **i.e. the same, over a period of time.** Frequent changes in accounting policies will distort comparison.

 # Consistency is also one of the Fundamental Accounting Assumptions.

3. As per Consistency Concept, a change in an accounting policy should be made only -

(a) If the adoption of a different accounting policy is required by Statute, or (b) For compliance with an Accounting Standard, or (c) If it is considered that the change would result in a more appropriate presentation of the Financial Statements of the enterprise

I] Materiality Concept:- (Exam June 23)

1. As per Materiality Concept, all items having significant economic effect on the business should be disclosed in the Financial Statements. This principle is an exception to the full disclosure principle.

2. Materiality is more a subjective and a judgmental principle. For example, Stationery (like Notebooks, Calculator) purchased by the Firm, though not used fully in the accounting year purchased, is still shown as an expense of that year because of the Materiality concept. This is because the amount of such Stationery is very small to be shown in the Balance Sheet though it constitutes Assets of the Firm.

J] Full Disclosure Concept :-

Full disclosure principle is relevant to materiality concept. It requires that all material information has to be disclosed in the financial statements either on the face of the financial statements or in the notes to the financial statements.

Examples

1. Accounting policies need to be disclosed because they help understand the basis of accounting.
2. Details of contingent liabilities, contingent assets, legal proceedings, etc. are also relevant to the decision making of users and hence need to be disclosed. **3.** The company sold one of its subsidiaries to the spouse of one of its directors. The information is material and needs disclosure.

K] Accrual Concept:- (Exam Dec 22)

The Accrual Concept makes a distinction between receipt of cash and the right to receive cash, and payment of cash and the legal obligation to pay cash in relation to revenues and expenses.

2. Accrual means recognition of revenue as they are earned and the cost as they are incurred and not as money is received or paid. This Concept relates to measurement of income, identifying assets and liabilities. [This concept is also one of the Fundamental Accounting Assumptions.]

The accrual 'basis of accounting' includes considerations relating to deferrals, allocations, depreciation and amortisation. Financial statements prepared on the accrual basis inform users not only of past events involving the payment and receipt of cash but also of obligations to pay cash in future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions. Accrual basis is also referred to as mercantile basis of accounting.

3. Under Accrual Concept, the effect of all transaction and events are recognized on mercantile basis, i.e.as they are earned or incurred and recorded in the Financial Statements of the period to which they relate, and not when cash is actually received or paid.

L] Cost Concept:- (Exam May 2019)

Meaning: As per Cost Concept, Value of an asset as shown in the Balance Sheet must be its Historical Cost, i.e. Acquisition Cost. This is the conventionally adopted measurement base for valuation of assets.

Significance / Merits:

(a) Historical Cost represents an actual figure / outflow of resources for acquiring the asset, and does not reflect a hypothetical or notional figure. (b) Historical Cost is easier to ascertain than Current Cost, Present Value, etc.

M] Realisation concept:- (Exam Dec 23)
Meaning: As per Realisation Concept, An asset is recorded at its Historical Cost and any change in its **value should only be recognised when it is realized, i.e. at the time of its actual sale / disposal.**

11] What do you mean by principal books of accounts? (Exam Paper Dec 2021)

Ledger is known as principal books of accounts as it provides full information regarding all the transactions pertaining to any individual account. Ledger contains all set of accounts (viz. personal, real and nominal accounts)

12] Explain Following Terminology:- (Exam paper Dec 23/ June 23)

1) Extra-ordinary item 2] Floating charge 3] Capital commitment 4] Expired cost 5) Obsolescence 6] Posting 7] Conversion cost 8] Diminishing Balance Method

1] Extraordinary items
These are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly.

2] Floating charge is a general charge on some or all assets of an enterprise which are not attached to specific assets and are given as security against a debt.

3] Capital commitment:- (Exam Jan 2021) Future liability for capital expenditure in respect of which contracts have been made.

4]Expired cost: The portion of the expenditure from which no further benefit is expected. Also termed as expense.

5] Obsolescence: **Diminution in the value of an asset** by reason of its becoming out-of-date or less useful due to technological changes, improvement in production methods, change in market demand for the product or service output of the asset, legal or other restrictions.

6] Posting:- (RTP Sept 24) <u>Posting is the process of transferring the transactions recorded in the books of original entry in the concerned accounts opened in the ledger.</u> It may be done daily, weekly, fortnightly or monthly according to the convenience and requirements of the business.

<u>Necessity of Posting:</u>It is necessary to post all journal entries into various accounts in the ledger because posting helps in knowing the net effect of various transactions during a given period on a particular account

7] Conversion Cost:
Cost incurred to convert raw materials or components into finished or semi-finished products. This normally includes costs which are specifically attributable to units of production, i.e., direct labour, direct expenses and subcontracted work, and production overheads as applicable in accordance with either the direct cost or absorption costing method.

8] Diminishing Balance Method:
It is a method under which the periodic charge for depreciation of an asset is computed by applying a fixed percentage to its historical cost or substituted amount less accumulated depreciation (net book value). This is also referred to as written down value method.

13] Discuss the rules if there is no Partnership Agreement. (Exam Jan 2021)
Ans: -
As per the Indian Partnership Act, 1932, in the absence of any agreement among the partners,
1. No partner has the right to a salary,
2. No interest is to be allowed on capital,
3. No interest is to be charged on the drawings,
4. Interest at the rate of 6%.p.a is to be allowed on a partner's loan to the firm, and
5. Profits and losses are to be shared equally.

III] Important Differences:-

1] Book-keeping and Accounting. (RTPs & MTPs)

Basis	**Book-keeping**	**Accounting**
Scope	Book-keeping involves – (a) Identifying the transactions, (b) Measuring the identified transactions, (c) Recording the measured transactions, (d) Classifying the recorded	**In addition to book-keeping,** Accounting involves- (a) Summarizing the classified transactions. (b) Analyzing the summarized results (c) Interpreting the analysed results, and (d) Communicating the information to interested parties.
Stage	Book-keeping is the primary stage, (i.e. record-keeping phase)	Accounting is the secondary (summarizing) stage. It starts where book-keeping ends.
Basic Objective	To maintain systematic records of financial transactions.	To ascertain net results of operations and financial position and to communicate information to the interested parties.
Who performs	Book-keeping work is performed by Junior Staff.	Accounting work is performed by Senior Staff.
Nature of job	Routine and clerical in nature.	Analytical in nature.
Financial position	Financial position of the business cannot be ascertained.	Financial position of the business is ascertained based on the accounting reports.

Financial Statements	Financial Statements do not form a part of the book-keeping process.	Financial Statements are part of the accounting process.

2] Trade and cash discount

Basis of Distinction	**Trade Discount**	**Cash Discount**
1. Purpose	It is allowed to promote the sales or as a trade practice.	It is allowed to encourage the prompt payment.
2. Time when allowed	It is allowed on purchase of goods.	It is allowed on immediate payment or payment within a specified period.
3. Disclosure in the Invoice	It is shown by way of deduction in the invoice itself.	It is not shown in the invoice.
4. Ledger Account	Trade Discount Account is not opened in the ledger.	Cash Discount Account is opened in the ledger.

3] Debit note & Credit note:-

Basis	**Debit Note**	**Credit Note**
1. Meaning	A debit note is **prepared by the purchaser** and **contains the date of return, name of the supplier to whom the goods** have been returned, details of the goods returned, reasons for returning the goods.	**A credit note** is prepared by **the seller** and contains the date of return of goods, the name of the customer who has re-turned the goods, details of goods received back and the amount of such goods.
2. Source Document	It is used as source document for recording in **Purchase Return Book.**	It is used as source document for recording in **Sales Return Book.**
3. Why Prepared?	It is prepared to debit supplier's account.	It is prepared to give credit to customer.

4] Contingent & other liability

Basis	**Contingent Liability**	**Other Liability**
1. Meaning	It is an obligation which may or may not arise depending upon the happening or non-happening of an uncertain future event.	It is a present obligation arising from past events the settlement of which is expected to result in an outflow of resources embodying economic benefits.
2. Dependence of occurrence	Its occurrence depends on the happening or non-happening of an uncertain future event.	It is already occurred.
3. Certainty of outflow of resources	There is no certainty of outflow of resources.	There is certainty of outflow of resources.

4. Recognitions	It is not recognised in the financial statements.	It is recognised in the financial statements.
5. Disclosure	It is disclosed merely by way of footnote to balance sheet.	It is disclosed on the liabilities side of the Balance Sheet.
6. Examples	1. Bills discounted but not yet matured 2. Arrears of dividend on Cum. Pref. share	1. Creditors for goods 2. Outstanding expenses.

5] Provision & Contingent liability (Exam Nov 22)

	Provision	*Contingent liability*
(1)	Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation.	A Contingent liability is a possible obligation that may or may not crystallise depending on the occurrence or non-occurrence of one or more uncertain future events.
(2)	A provision meets the recognition criteria.	A contingent liability fails to meet the same.
(3)	Provision is recognized when (a) an enterprise has a present obligation arising from past events; an outflow of resources embodying economic benefits is probable, and (b) a reliable estimate can be made of the amount of the obligation.	Contingent liability includes present obligations that do not meet the recognition criteria because either it is not probable that settlement of those obligations will require outflow of economic benefits, or the amount cannot be reliably estimated.
(4)	If the management estimates that it is probable that the settlement of an obligation will result in outflow of economic benefits, it recognises a provision in the balance sheet.	If the management estimates, that it is less likely that any economic benefit will outflow from the firm to settle the obligation, it discloses the obligation as a contingent liability.

6] Journal & Ledger (RTP Sept 2024)

Basis of Distinction	**Journal (Past RTPs)**	**Ledger**
1. Nature of Book	It is book of original or **prime entry.**	It is book of final or **secondary entry.**
2. Basis for Preparation	It is prepared on the basis of **source documents**of transactions.	It is prepared on the basis of **Journal.**
3. Stage of Recording	Recording in the journal in the **first**stage.	Recording in the ledger is the **second**stage.
4. Object	It is prepared **to record all transactions in chronological order.**	It is prepared **to know the net effect** of various transactions affecting a particular account.

5. Name of the Process of recording entries	The process of recording in journal is called **'Journalising'.**	The process of recording in the ledger is called **'Posting' . (RTP Sept 24)**
6. Basis of Preparation of Final Accounts	Journal directly does **not serve** as basis for the preparation of final accounts.	Ledger **serves** the basis for the preparation of final accounts.

7] Capital & revenue expenditure (MTP SEPT 24)

Basis of Distinction	**Capital Expenditure**	**Revenue Expenditure**
1. Meaning	It is an expenditure which is incurred: (a) to acquire or bring into existence an asset, or (b) to acquire or bring into existence an advantage or benefit of an enduring nature, or (c) to increase the productivity or earning capacity.	It is an expenditure which is incurred: (a) to maintain the productivity or earning capacity of a business, or (b) to carry out operating activities in the normal course of business.
2. Benefits	It normally yields benefits beyond current accounting period.	It normally does not yield benefits beyond current accounting period.
3. Accounting Treatment	It is debited to the Respective Asset Account.	It is debited to Trading/Profit and Loss Account.
4. Examples	(a) Cost of Land and Building (b) Cost of Plant and Machinery (c) Cost of Furniture and Fixtures	(a) Depreciation on Land and Building (b) Rent of Machines (c) Repairs of Building (d) Insurance of Building

8] Capital & Revenue receipts:- (MTP)

Basis	**Capital Receipts**	**Revenue Receipts**
1. Meaning	Capital receipts refer to those receipts which are not revenue in nature.	Revenue receipts refer to those receipts which arise in the normal course of business.
2. Accounting Treatment	These are credited to the Respective Account of Capital Nature.	These are credited to Trading/ Profit and Loss Account.
3. Examples	(a) Sale of Land and Building by a person other than a dealer in real estate, (b) Raising of Loan by a person other than one engaged in the business of finance/banking, (c) Raising of Capital.	(a) Sale of Land and Building by a dealer in real estate. (b) Raising of Loan by a person engaged in the business of finance/banking.

9] Deferred revenue and prepaid expenses: -

Particulars	Deferred Revenue Expenses	Prepaid Expenses
Meaning	Deferred revenue expenditure as that expenditure for which payment has been made or a liability incurred, but which is carried forward on the presumption that ***it will be of benefit over a subsequent period or periods.***	It refers to an expense ***paid but not incurred*** during the current accounting period.
Where it is to be shown in B/S	It is shown on the assets side of the Balance Sheet under the head ***"Miscellaneous Expenditure".***	It is shown on the assets side as ***Current Asset***.
Nature	Deferred revenue expenditure should be revenue expenditure by nature in the first instance	It is revenue expenditure.
Measurement	The benefits available from deferred expenses ***cannot be precisely estimated***	The benefits available from prepaid expenses ***can be precisely estimated***
Consider	Deferred expenses are considered ***Fictitious Assets***	prepaid expenses are considered as ***Current Assets***.

10] Outstanding & prepaid expenses: -

Particulars	Outstanding Expenses	Prepaid Expenses
Meaning	It refers to an **expense incurred but not paid** during the current accounting period	It refers to **an expense paid but not incurred** during the current accounting period.
Payment	It is **yet to be paid**.	It has **already been paid**.
Incurred	It has **already been incurred**.	It is **yet to be incurred.**
Year to which the item relates	It is an item of the **Current year**.	It is an item of the **Next year**.
Treatment in Income Statement	It is shown by way of **Addition** to the relevant item.	It is shown by way of **Deduction** from the relevant item.
Treatment in Balance Sheet	It is shown on the liabilities side as a **Current Liability**.	It is shown on the assets side as **Current Asset.**

11] Reserve & provision: - (Exam Nov 22)

Particulars	Reserves	Provisions
Relation to Profit	**Appropriation** of Profit	**Charge** against Profit
When it can be created?	Reserves cannot be created unless there is a profit.	Provision should be created even if there is no profit

Nature	Generally, Reserves are optional, based on Managerial discretion to appropriate profits.	Provisions are necessity based on accounting principles.
Utilisation for dividends	It can be utilised for distri-bution by way of dividends.	It cannot be utilised for distribution by way of dividends.
Examples	General Reserve , Contingency Reserve	Provision for Tax , Provision for Doubtful Debts

12] Share &Debenture: - (Study Material)

	Share	**Debenture**
Ownership	Provides ownership in the company	Does not provide ownership
Identity	Known as a shareholder	Known as a debenture holder
Nature of return	Dividend	Interest
Certainty of return	No certainty - @ variable rate	Fixed rate.
Requirement of profit	As it is an appropriation of profit, no certainty of returns. No profit- no return.	Charge against profit. Company has to pay at fixed rate whether it has earned profit or not.
Convertibility	Cannot be converted into debentures	Can be converted into shares
Control & voting right	Right to participate and vote on the company's decisions	No control or voting right provided
Losses	Will also shoulder the losses	Does not have to suffer any losses
In case of liquidation	At last – After paying secured creditors, debenture holders and unsecured creditors.	Debenture holders get priority in getting their money back
Mortgage	Assets of the company cannot be mortgaged in favour of shareholders.	Assets of the company can be mortgaged in favour of debenture holders.
Interest/ Dividend	Not fixed, if profits are higher so is the dividend	Fixed interest rate
Participation in surplus profit	Yes	No
Level of risk	High as not secured.	Low as secured.
Disclosure in Balance sheet	In the Company's Balance Sheet, shares are shown under "Shareholdesr's Fund" detailed in 'Share Capital' of Notes to Accounts.	In the Company's Balance Sheet, Debentures are shown under "Long Term Borrowings".
Forfeiture	Forfeited if calls are not paid	Can not be forfeited upon non payment of calls.
Discount	Cannot be issued @ discount.	Can be issued @ discount.

13] FIFO & LIFO method: - (MTP June 23)

Particulars	FIFO Method	LIFO Method
Assumption	Goods coming in first will go out first	Goods coming in later will go out first.
Closing Stock	Closing Stock consists of latest purchases	Closing Stock consists of earlier purchases
Valuation	Closing Stock will be valued at the Current market prices.	Closing Stock will be valued at the prices of initial purchases
Inflation - Prices Increase / rising prices	Value of Closing Stock will be higher Cost of Goods Sold will be lower	Value of Closing Stock will be lower Cost of Goods Sold will be higher
Deflation - Prices decrease /falling prices	Value of Closing Stock will be lower Cost of Goods Sold will be higher	Value of Closing Stock will be higher Cost of Goods Sold will be lower
Matching of costs	Current Costs are NOT matched with the current revenues	Current Costs are MATCHED with the current revenues
Recognition	Approved by AS-2	NOT approved by AS-2

14] Periodic v. perpetual inventory system: - (Exam Nov 2019)

	Periodic Inventory System	Perpetual Inventory System
1.	This system is based on physical verification.	It is based on book records.
2.	This system provides information about inventory and cost of goods sold at a particular date	It provides continuous information about inventory and cost of sales.
3.	This system determines inventory and takes cost of goods sold as residual figure.	It directly determines cost of goods sold and computes inventory as balancing figure.
4.	Cost of goods sold includes loss of goods as goods not in inventory are assumed to be sold.	Closing inventory includes loss of goods as all unsold goods are assumed to be in Inventory
5.	Under this method, inventory control is not possible.	Inventory control can be exercised under this system.
6.	This system is simple and less expensive.	It is costlier method.
7.	Periodic system requires closure of business for counting of inventory.	Inventory can be determined without affecting the operations of the business.

16] Real & Nominal Accounts:-

Basis of Distinction	Real	Nominal
1. Meaning	These accounts relate to the tangible or intangible real assets.	These accounts relate to expenses, losses, profits and gains.
2. Examples	Tangible — Land A/c Intangible — Goodwill A/c	Expenses — Purchases A/c Loss — Loss by Fire A/c Profits & Gains — Sales A/c Discount Received A/c
3. Closing entries	No closing entry is passed to close these accounts.	Closing Entries are passed to close these accounts.
4. Where shown	These are shown in the Balance Sheet.	These are transferred to Trading & Profit & Loss A/c.

17] Double entry system v Single entry system/ Incomplete records system

Basis of Distinction	**Double Entry System (Exam 2024)**	**Incomplete Records System**
Meaning	**Single entry system is an incomplete system of recording financial transactions.**	**Double entry system is a complete system of recording and reporting financial transactions.**
1. Basis of the system.	**It is based on certain assumptions, Concepts and principles**	**It is not based on assumption and principles.**
2. Dual aspect concept	**Double entry system of accounting is based on dual aspect concept.**	**Single entry does not follow dual aspect concept.**
3. Nature of accounts maintained	**All types of accounts—Personal, Real & Nominal, are maintained.**	**Usually, Cash and Personal accounts are maintained.**
4. Trial Balance	**Arithmetical accuracy of the records can be checked by preparing a Trial Balance.**	**Arithmetical accuracy of the records cannot be checked since trial Balance cannot be prepared**
5. Determination of True Profit or Loss	**True profits or losses can be determined by preparing Trading and Profit & Loss Account.**	**Only estimated profit or losses can be determined since Trading & Profit and Loss Account cannot be prepared.**
6. Financial position	**True financial position can be known by preparing a Balance Sheet.**	**Only estimated financial position ca~ be known on the basis of Statement of Affairs.**
7. Utility	**It is used by all types of traders.**	**It is used only by small traders.**
8. Recognition	**Records maintained according to this system are recognized by the government.**	**Records maintained according to this system are not recognized by the government.**

18] Profit & Loss Account v Income and Expenditure Account

	Profit and Loss Account	Income & Expenditure Account
1	It is prepared by business undertaking.	It is prepared by non-trading organizations.
2	The credit balance of Profit and Loss Account is known as "net profit" and added to opening capital.	Credit balance of Income and Expenditure Account is known as excess of income over expenditure or surplus and added to opening capital fund.
3	The debit balance of this Profit and Loss Account is known as "net loss" and deducted from opening capital.	Debit balance of this Income and Expenditure Account is known as "excess of expenditure over income' or deficit and deducted from opening capital fund.
4	To check correctness of accounts trial balance is prepared before preparing this account.	To check correctness of accounts, receipts and payments account is prepared before preparing this account.

19] Receipts Payments & Income & Expenditure Account

	Receipts & Payments Account	Income & Expenditure Account
1	It is a summarized Cash Book	It closely resembles the Profit & Loss Account of a Trading concern.
2	Receipts are debited and Payments are credited.	Incomes are credited and Expenditures are debited.
3	Transactions are recorded on Cash basis.	Transactions are recorded on Accrual Basis
4	Amounts related to previous period or future period may remain included. Outstanding amount for current year is excluded.	Transactions are recorded on accrual basis. All amounts not related to the current period are excluded. Outstanding amounts of current period are added.
5	It records both Capital and Revenue transactions.	It records Revenue transactions only.
6	It serves the purpose of a Real Account.	It serves the purpose of a Nominal Account.
7	It starts with opening Cash and Bank Balances and ends with closing Cash and Bank Balances.	It does not record such balances, rather its final balance shows a surplus or a deficit for the period.
8	It does not record notional loss or noncash expenses like bad debts, depreciations etc.	It considers all such expenses for matching against revenues
9	Its closing balance is carried forward to the same account of the next accounting Period.	Its closing balance is transferred to Capital Fund or General Fund or Accumulated Fund in the same period's Balance Sheet.
10	It helps to prepare an Income & Expenditure Account.	It helps to prepare a Balance Sheet.

20] Tangible Asset V Intangible Asset:- (RTP JUNE 2024)

Tangible Assets	Intangible Assets
Tangible Assets are assets that have a physical substance i.e., they can be seen and touched, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.	Intangible Assets are identifiable assets that do NOT have a physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.
Tangible Assets have a finite life based on expected usage.	Intangible Assets have a finite life based on contractual terms. In some cases, intangible assets could also have indefinite life e.g. purchased goodwill.
Useful life is based on expected usage, with no presumption laid down for the same.	Useful life of Intangible Assets is presumed not to exceed 10 years unless evidence exists to the contrary.

Tangible Assets are depreciated over the useful life. In other words, writing off the value of tangible assets on an annual basis is known as depreciation	Intangible Assets are amortised over the useful life. In other words, writing off the value of intangible assets on an annual basis is known as amortisation.
Examples include Property, Machinery, Vehicles etc.	Examples include software, streaming rights, landing rights, trademarks, patents etc.

21] Fundamental Accounting assumptions v Accounting Policies:- (RTP JAN 25, JUNE 24,MAY 22, May 21, Nov 20, may 2018, May 2019, Exam Paper June 2024

Fundamental Accounting Assumption	Accounting Policies
There are three fundamental accounting assumptions viz. Going Concern, Consistency and Accrual.	There is no single list of accounting policies which are applied in all circumstances. As a result, there may be different accounting policies adopted by different enterprises.
No disclosures is required if all the fundamental assumptions have been followed.	Disclosure is required if a particular accounting policy has been followed.
If fundamental accounting assumption is not followed, it is to be disclosed in the financial statements together with the reasons.	If the policy is changed in subsequent year, the effect of such change should be disclosed in the financial statements.
There is no option to choose fundamental accounting assumptions.	The firm has an option to select a particular policy.

22] Trade bill and Accommodation bill (RTP May 2018, MAY 2020) (MTP I SEPT 2024)

Basis	Trade Bill	Accommodation Bill
Meaning	Trade bills are usually drawn to facilitate trade transmission, that is, these bills are meant to finance actual purchase and sale of goods.	On the other hand, an accommodation bill is one which is drawn, accepted or endorsed for the purpose of arranging financial accommodation for one or more interested parties.
Amount to be kept after discount	On discounting of a trade bill, full amount is retained by the drawer.	In an accommodation bill however, the amount may be shared by the drawer and the drawee in an agreed ratio.
Sharing of discount	Discount expenses are to be borne by drawer.	Discount expenses are to be borne by both drawer and acceptor.
Consideration	Trade bill is drawn for some consideration	While accommodation bill is drawn and accepted without any consideration.
Evidence	Trade bill acts as an evidence of indebtedness	While accommodation bill acts as a source of finance.
Legal Action	In order to recover the debt, the	In accommodation bill, legal

	drawer can initiate legal action on a trade bill.	remedy for the recovery of amount may not be available for immediate parties.

23] Accrual v Cash system of Accounting (Exam paper Dec 2021)

Basis	Accrual system of Accounting (Exam Dec 22)	Cash system of Accounting
Meaning	Accrual Basis of Accounting is a method of recording transactions by which revenue; costs, assets and liabilities are reflected in the accounts for the period in which they accrue.	Cash Basis of Accounting is a method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts for the period in which actual receipts or actual payments are made.
Prepaid / outstanding Exp	Under this, there may be prepaid/ outstanding expenses and accrued/ advance incomes in the Balance Sheet.	Under this, there is no prepaid/outstanding expenses and accrued/ advance incomes in the Balance Sheet.
Recording of expenses	When liability to pay arise.	When payment is to be made.
Recording of income	When right to receive is certain	When income is received
Concept	It follows accrual concept of accounting. Also known as concept of prudence.	It does not follow accrual concept.
Credit transactions	Credit transactions are recorded like credit sales , credit purchase etc. Debtors , creditors, prepaid , outstanding exp are shown in financial statements.	No credit transactions are recorded. Financial statements do not show debtors , creditors , prepaid , outstanding etc.
Suitable	Suitable to Company and big organizations whose accounts are required to be audited.	Small organizations, sole proprietors, professional person and non profit organizations generally follows cash system.
Ease of maintenance	As Multiple accounts are to be prepared it is complex system requires expert knowledge of accounting.	As income and expenditure are recorded as & when they received or paid it is comparatively easy to maintain.
Profit & Financial Position	As it records transaction on accrual basis Financial statements show true profit & real financial position.	It does not show expenses payable or income receivable. It shows only cash profit.